Internal Revenue Service

Department of the Treasury

200012083

Washington, DC 20224

Uniform Issue List No: 401.29-00

Contact Person:

Telephone Number:

In Reference to: T:EP:RA:T4

Date:

DEC 27 1999

Legend:

Employer X =

Plan A =

Plan B =

Trust C =

State D =

Dear

This is in response to a ruling request submitted on your behalf by your authorized representative dated October 20, 1998, and supplemented by additional correspondence dated May 24, 1999, August 18, 1999 and September 7, 1999. The ruling request concerns the tax treatment of elective deferrals to a cash or deferred arrangement in coordination with a nonqualified deferred compensation plan. The following facts and representations were submitted by your authorized representative.

Employer X currently maintains Plans A and B. Plan A is a profit sharing plan intended to qualify under section 401(a) of the Internal Revenue Code ("Code") containing a cash or deferred arrangement intended to qualify under section 401(k) of the Code. Plan B is a nonqualified deferred compensation plan available to a group of management or highly compensated employees selected by Employer X. Employees who are eligible to participate in Plan B must be eligible to participate in Plan A. You are eligible to participate in both Plan A and Plan B.

Under Plan A, participants are eligible to make salary deferral contributions subject to the annual dollar limitation of section 402(g) of the Code and the actual deferral percentage limitation of section 401(k)(3) of the Code. Employer X may make matching contributions to Plan A with respect to salary deferral contributions. Employer X may also make discretionary contributions to Plan A. Matching contributions and discretionary contributions made to Plan A are subject to a graded three-year vesting schedule.

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Plan B provides for salary deferral contributions and employer matching contributions. The employer matching contributions are subject to a vesting schedule. The salary deferral, matching contribution and vesting provisions of Plan B mirror the salary deferral, matching contribution and vesting provisions of Plan A.

Prior to each January 1, a participant may elect to enter into an irrevocable salary reduction agreement no later than December 31 of the calendar year preceding the year in which the compensation to which the salary deferral relates is earned. Pursuant to the election, a participant will specify the percentage of compensation otherwise payable for the ensuing calendar year that will be deferred under Plan B. Employer X will make matching contributions to Plan B with respect to the amounts deferred up to six percent of compensation.

Salary deferrals and other contributions are made to Plan B through Trust C. Trust C meets the requirements of Revenue Procedure 92-64. Trust C is valid under the laws of State D. Plan B provides that all amounts under Plan B shall remain the property of Employer X subject to the claims of Employer X's creditors. Participants and beneficiaries in Plan B have no preferred claim on, or any beneficial ownership interest in, any property, rights or investments held by Employer X in connection with Plan B.

As soon as practicable after the end of the plan year of Plan A (i.e., calendar year), but no later than January 31 of the ensuing plan year, Employer X will perform preliminary actual deferral percentage ("ADP") and actual contribution percentage ("ACP") testing to determine the maximum permissible salary deferrals that could be made for such plan year, consistent with section 402(g) of the Code and the limitations of section 401(k)(3), on behalf of each participant to Plan A. If a participant has elected to have salary deferrals under Plan B transferred to Plan A, the lesser of the maximum permissible salary deferrals determined in accordance with the preceding sentence or the participant's salary deferrals under Plan B for that year will be transferred to Plan A. The transfer will occur no later than March 15 of the plan year next-following the plan year with respect to which the determination of the maximum permissible salary deferrals is made. The election to have such amount transferred to Plan A will be made at the same time as the participant elects to enter into a salary reduction agreement with Employer X under Plan B. Any amount in excess of the maximum permissible salary deferrals will remain in Plan B and accumulate earnings until a distributable event occurs under the terms of Plan B. If a participant does not elect to have salary deferrals transferred from Plan B to Plan A, then the maximum permissible salary deferrals under Plan B for that year will be returned to the participant. Any refund of salary deferrals will be included in a participant's taxable income for the year with respect to which the salary deferrals were made.

The determination of the amount of salary deferrals transferred from Plan B to Plan A will be calculated in accordance with the provisions of Plan A and Plan B, as reflected in the election forms associated with both Plans. These provisions preclude employer discretion with respect to the amount of salary deferrals transferred from Plan B to Plan A on behalf of any participant.

Matching contributions made on behalf of a participant to Plan B will be transferred to Plan A to the extent such matching contributions would have been made to the participant's Plan A account.

No earnings credited under Plan B will be transferred to Plan A. Thus, salary deferrals under Plan A that result from salary deferrals under Plan B will consist solely of amounts that were otherwise payable to the participant as current compensation for the plan year involved and for which a deferral election has been made. Any matching contributions associated with such salary deferral contributions will be in the same amounts as would be made if the salary deferrals were directly made, subject to the actual contribution percentage test of section 401(m) of the Code.

All salary deferral and matching contributions under Plan A will be treated similarly. A participant will be fully vested in salary deferral contributions and will be entitled to a distribution only upon separation from service, termination of the plan without establishment or maintenance of another defined contribution plan, a sale of the company that complies with section 401(k)(10) of the Code, attainment of age 591/2, death, disability, or hardship.

With respect to the foregoing, the following rulings are requested:

(1) Assuming that Plan A otherwise satisfies the requirements for a qualified cash or deferred arrangement and that the elective deferrals and actual deferral percentage limitations of sections 402(g) and 401(k)(3) of the Code are not exceeded, elective deferrals made by you under Plan A that are initially held by Employer X pursuant to the terms of Plan B will be excluded from gross income under section 402(e)(3) of the Code.

(2) For purposes of satisfying the section 402(g) limit of the Code, elective deferrals under Plan A made by you for a given plan and calendar year that are initially held by Employer X pursuant to the terms of Plan B will be treated as having been made in the calendar year in which they would have been otherwise received as wages by you.

Section 401(k)(2) of the Code provides, in pertinent part, that a qualified cash or deferred arrangement is any arrangement which is a part of a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan which meets the requirements of section 401(a), and under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash.

Section 1.401(k)-1(a)(3)(i) of the Income Tax Regulations ("Regulations") provides that a cash or deferred election is any election (or modification of an earlier election) by an employee to have the employer either (A) provide an amount to the employee in the form of cash or some

other taxable benefit that is not currently available, or (B) contribute an amount to a trust, or provide an accrual or other benefit, under a plan deferring the receipt of compensation. A cash or deferred election includes a salary reduction agreement between an employee and employer under which a contribution is made under a plan only if the employee elects to reduce cash compensation or to forgo an increase in cash compensation.

Under section 1.401(k)-1(a)(3)(ii) of the Regulations, a cash or deferred election can only be made with respect to an amount that is not currently available to the employee on the date of the election.

Under section 1.401(k)-1(a)(3)(iii) of the Regulations, cash or another taxable amount is currently available to the employee if it has been paid to the employee or if the employee is able currently to receive the cash or other taxable amount at the employee's discretion.

Under section 1.401(k)-1(b)(4)(i) of the Regulations, an elective contribution is taken into account for purposes of the actual deferral percentage test for a plan year only if (A) the elective contribution is allocated to the employee's account under the plan as of a date within that plan year, and (B) the elective contribution relates to compensation that either (1) would have been received by the employee in the plan year but for the employee's election to defer under the arrangement, or (2) is attributable to services performed by the employee in the plan year and, but for the employee's election to defer, would have been received by the employee within two and one-half months after the close of the plan year. An elective contribution is considered allocated as of a date within the plan year only if: (1) the allocation is not contingent upon the employee's participation in the plan or performance of services on any date subsequent to that date, and (2) the elective contribution is actually paid to the trust no later than the end of the 12-month period immediately following the plan year to which the contribution relates.

Section 402(e)(3) of the Code provides, in pertinent part, that contributions made by an employer on behalf of an employee to a trust which is a part of a qualified cash or deferred arrangement (as defined in section 401(k)(2)) shall not be treated as distributed or made available to the employee nor as contributions made to a trust by the employee merely because the arrangement includes provisions under which the employee has an election whether the contribution will be made to the trust or received by the employee in cash.

Under section 402(g)(1) of the Code, the elective deferrals of any individual for any taxable year are included in such individual's gross income to the extent the amount of such deferrals for the taxable year exceeds $7,000 (as adjusted under section 402(g)(5) of the Code), notwithstanding section 402(e)(3) of the Code regarding elective deferrals under a qualified cash or deferred arrangement.

With respect to ruling request one, you are eligible to defer compensation under Plan A and Plan B by making two irrevocable elections. The elections must be made no later than

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December 31 of the calendar year preceding the year in which the compensation to which the salary deferral election relates is earned. First, you elect the amount of compensation to be deferred under Plan B. Second, you elect to have the portion of such Plan B deferrals equal to the maximum permissible salary deferrals under Plan A (or if the Plan B deferrals are less than the maximum permissible salary deferrals under Plan A, then the entire Plan B deferrals) transferred to Plan A. If you do not elect to transfer any salary deferrals to Plan A, the maximum permissible salary deferrals that could have been transferred will be returned to you. In no event will either the transfer of the maximum permissible salary deferrals to Plan A or the return of such deferrals to you be made later than March 15 of the year following the year for which the deferral election was made.

In addition, for purposes of the actual deferral percentage test under section 401(k)(3) of the Code for a calendar year plan year, elective deferrals irrevocably and prospectively elected under Plan B made by you for a calendar year plan year that are initially held in the general assets of Employer X and then contributed to Plan A will be treated as having been made under Plan A in the calendar year in which the compensation to which the deferrals relate was earned by you, provided that the elective deferrals are allocated to your account by the end of that calendar plan year and the elective deferrals continue to relate to compensation that either would have been received by you in the calendar year plan year but for your election, or is attributable to services performed by you in the calendar year plan year and would have been received by you within 2 ½ months after the calendar year plan year but for your election. An election to make a contribution to Plan A is a cash or deferred election within the meaning of section 1.401(k)-1(a)(3)(i) of the Regulations because it is an election to have Employer X provide a benefit under a plan deferring compensation rather than providing an amount in cash to the employee.

Accordingly, with respect to ruling request one, we conclude that, assuming Plan A otherwise satisfies the requirements for a qualified cash or deferred arrangement and that the elective deferral and actual deferral percentage limitations of sections 402 (g) and 401 (k) (3) of the Code are not exceeded, elective deferrals made by you under Plan A that are initially held by Employer X pursuant to the terms of Plan B will be excluded from gross income under section 402 (e) (3) of the Code when contributed to Plan A, provided such contribution is timely paid and allocated.

With respect to ruling request two, you will make an irrevocable election to have your maximum permissible salary deferrals initially held by Plan B transferred to Plan A on your behalf The maximum permissible salary deferrals that may be transferred to Plan A would be subject to the limitation of section 402(g) for the year in which the salary deferrals were earned rather than in the year in which such amount is transferred to Plan A. If the maximum permissible salary deferrals are returned to you, they will be taxable to you in the year such amount was earned, rather than the year such amount is actually returned to you.

Accordingly, with respect to ruling request two, we conclude that for purposes of satisfying the limitations of section 402(g) of the Code, contributions made to Plan A by Employer X on your behalf (assuming that such contributions are timely made and timely allocated to your account under Plan A), which are initially held by Employer X pursuant to the terms of Plan B, will be treated as salary deferrals under Plan A having been made in the year in which they would have been taxable to you but for your election under Plan B to have such salary deferrals contributed to Plan A.

The above rulings are based on the assumption that at all times relevant to these rulings, Plan A is qualified under section 401 (a) of the Code, and its cash or deferred arrangement is qualified under section 401 (k) (2) of the Code.

This ruling is directed only to the taxpayer that requested it and applies only with respect to Plan A as submitted with this request. Section 6110(k)(3) of the Code provides that this private letter ruling may not be used or cited as precedent. Title I of Employee Retirement Income Security Act of 1974 (ERISA) is within the jurisdiction of the Department of Labor. Accordingly, we express no opinion as to whether the subject transactions comply with Title I of ERISA. Finally, no opinion is expressed as to the income tax consequences of establishing Plan B and participating in it, except as expressly stated herein.

In accordance with a power of attorney on file with this office, a copy of this ruling is being sent to your authorized representative.

Sincerely yours,

John G. Riddle, Jr.

John G. Riddle, Jr.
Chief, Employee Plans
Technical Branch 4

Enclosures
Deleted Copy of the Letter
Notice 437

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